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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 425

HOLMES PROJECTOR COMPANY,
Petitioner,

vs.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

GEORGE F. VON KOLNITZ, JR.,
HAROLD E. MARKS,
Counsel for Petitioner.

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No. 425

HOLMES PROJECTOR COMPANY,
Petitioner,

vs.

THE UNITED STATES,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Petitioner, Holmes Projector Company, an Illinois corporation, respectfully prays that a Writ of Certiorari issue to review the judgment of the Court of Claims entered in the above entitled case, on July 15, 1952; the time for filing this Petition having been extended to November 3rd, 1952, by order of this Court, dated October 13, 1952.

I

Summary Statement of Matter Involved

This was a suit in the Court of Claims to recover the amount of income taxes paid by the Petitioner in 1946 upon income from War Contracts dated in 1945, subject to re-

negotiation, which income was claimed to have been erroneously accrued by the Petitioner and reported in its tax returns for 1945, despite the fact that the renegotiation of said contracts did not occur until December 23, 1946, on which date the amount of the profits allowable to Petitioner under said contracts, and for which the Government became liable, was definitely determined and fixed for the first time, and that Petitioner keeps its books and makes its tax returns on the basis of accrual accounting.

II

Relevant Part of Statute Involved

Section 3806(a)(4) of the Internal Revenue Code provides as follows:

> "EXCEPTION. The foregoing provisions of this subsection shall not apply in respect of any contract if the taxpayer shows to the satisfaction of the Commissioner that a different method of accounting for the amount of the payment, repayment, or disallowance clearly reflects income, and in such case the payment, repayment, or disallowance shall be accounting for with respect to the taxable year provided for under such method, which for the purposes of subsection (b) and (c) (credit for prior tax) shall be considered a prior taxable year."

III

Question Presented

The sole question here involved is whether the amount of the allowable profit to which the Petitioner ultimately became entitled under War Contracts subject to renegotiation, and which amount was for the first time determined on December 23, 1946, as set forth in the Stipulation of Facts in the Record herein, on War Contracts dated in 1945, con-

stituted accrued income for the year 1946 or for the year 1945.

IV

The Reasons Relied On for the Allowance of the Writ

The reasons for petitioning this Court to review the decision and judgment of the Court of Claims in this case are as follows:

1

The holding of the Court of Claims herein in effect denying that the income here in question was taxable for 1946 and not for 1945, is contrary to the following decisions of this Honorable Court.

In *Lichter et al.* v. *United States,* 68 S. Ct. 1294, decided by this Court on June 14, 1948, this Court was called upon to pass on the constitutionality of the Renegotiation Act of 1942, as amended. Of necessity, this Court's decision in that case, involved as interpretation of the *vital* and *controlling* provisions of the Act.

In an exhaustive opinion, reviewing the necessity for the Act, and the underlying purpose and intent of Congress in respect thereof, and sustaining its constitutionality, this Court, after pointing out that the Government could have drafted the industry of America, in war time, as it drafted soldiers for the Armed Forces, among other things said:

> "The plan for Renegotiation of profits, which was chosen in its place by Congress appears in its true light as the very symbol of a free people united in reaching unequalled productive capacity and yet retaining the maximum of individual freedom consistent with a general mobilization of effort." • • •
>
> "The plan proved itself readily adaptable to the needs of the times. It called for initial contract *estimates* based upon the best available information at the time of entering into the contracts. Production pro-

> ceeded at once on the basis of those estimates. The final net compensation, however, resulted from a renegotiation made after both parties had had the benefit of actual experience under the contract. This determination of *the allowable profit* was guided by many relevant factors."

It is thus unmistakably clear that this Court has now defined the original War Contracts, prior to renegotiation as *"estimates"*, and has further conclusively stated that "The allowable profit",—and, of course, *nothing else, in respect of such contracts, was income subject to taxation*—was the amount which "resulted from a renegotiation made after both parties had had the benefit of actual experience under the contract."

The inevitable conclusion from the foregoing decision is that a War Contractor had no right to any amount as "allowable profit" until the renegotiations had been concluded. It follows, beyond peradventure of doubt, that the "allowable profit" became taxable income only in the year during which the renegotiation occurred.

As stipulated herein, the renegotiation of the Contracts here in question was concluded on December 23, 1946. *"The allowable profit"* of the Petitioner from said contracts was then *first determined,* and, therefore, the Petitioner should not have accrued, as it did, and paid taxes on any amount of profits from said contracts for the year 1945.

In *Spring City Foundry Co.* v. *Commissioner,* 292 U. S. 182, the Supreme Court said:

> "Keeping accounts and making returns on the *accrual basis, as distinguished from the cash basis,* import that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed the right accrues. • • • Items must be accrued

as income when the events occur to fix the amount due and determine liability to pay."

The decision of this Court in *Security Flour Mills* v. *Commissioner of Internal Revenue*, 321 U. S. 281, it is submitted, completely supports the petition of the plaintiff herein. In that case the Court said:

> "Where the accrual method of accounting is used, items of income and expenses must be allocated to the years in which the right to receive, or the obligation to pay has become final and definite in amount."

2

The question presented is an important question of Federal Income Tax Law, which should be settled by the Supreme Court.

3

The following obvious mistakes are in the Court of Claims decision against the Petitioner in this case:

1. On page 7 of the Decision, the following is stated:

> "There is no evidence in the record that the accrual method of accounting used by plaintiff did not clearly reflect its income for 1945."

The Stipulation of Facts in the record herein shows that the Petitioner accrued the face amount of the War Contracts here involved in 1945, and duly paid the taxes thereon, but that the amount of the profits to which the Petitioner ultimately became entitled, and to which the Government first became liable were agreed upon on December 23, 1946. It thus obviously and *unquestionably* is shown by the record herein, that the accrual method of accounting, used by plaintiff, did not clearly reflect its income for 1945.

2. On page 6 of the Decision, the following is stated:

> "It is obvious that Congress intended when it enacted Section 3806, supra, that the full amount of *earnings*

payable or paid under the terms of Government Contracts *should be regarded as income in the year* in which such amounts were *earned by performance* and were payable or paid in accordance with the *accrual* or *cash* basis of accounting." (Italics inserted.)

There is *no statement* in section 3806 re amounts "earned by performance", and it is a *fundamental* principle of Internal Revenue jurisprudence as expressed by the Supreme Court in *Gould* v. *Gould,* 245 U. S. 151, that in the interpretation of tax statutes "it is the established rule *not to extend* their provisions by implication beyond the clear import of the language used, or to enlarge their operations as to embrace matters not *specifically* pointed out."

Conclusion

For the foregoing reasons, it is respectfully submitted that this Petition for the Writ of Certiorari should be granted.

GEORGE F. VON KOLNITZ, JR.,
HAROLD E. MARKS,
208 South La Salle St.,
Chicago, Ill.,
Counsel for Petitioner.

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In the Supreme Court of the United States

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No. 425

HOLMES PROJECTOR COMPANY, *Petitioner*

v.

THE UNITED STATES

On Petition for a Writ of Certiorari to the United States Court of Claims

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (R. 14-18) is reported at 105 F. Supp. 690.

JURISDICTION

The judgment of the Court of Claims was entered on July 15, 1952. (R. 13.) A motion to alter the judgment was filed August 7, 1952, and

was overruled October 7, 1952. (R. 19.) The petition for a writ of certiorari was filed October 29, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1255(1).

QUESTION PRESENTED

Whether the petitioner, which kept its books of account and filed its tax returns on the accrual basis, completed war contracts during the year 1945, and was paid the face amount of such contracts in that year, may defer the payment of tax on such income until the year 1946 because renegotiation proceedings were completed in that year.

STATUTE INVOLVED

The applicable portions of the pertinent statute are set forth in the Appendix, *infra*, pp. 13-16.

STATEMENT

The special findings of fact of the Court of Claims (R. 12-14) may be summarized as follows:

The petitioner, an Illinois corporation, is, and during the periods here involved was, engaged in the manufacture and sale of motion picture projection equipment. (R. 12-13.)

During the year 1945, substantially all of the petitioner's income was derived from the proceeds of contracts with the War Department. The contracts around which the present issue revolves were fully performed in the year 1945, the stipulated amounts thereof were accrued on peti-

tioner's books during that year, and the War Department paid such amounts to the petitioner in that year. The contracts contained appropriate provisions pursuant to the Renegotiation Act of 1943 for the renegotiation of the contract prices to eliminate therefrom any profits determined by the Renegotiation Board to be excessive. (R. 13.)

On May 7, 1946, pursuant to an extension of time granted by the Commissioner of Internal Revenue, petitioner filed for the year 1945 its income and declared value excess profits tax return and its excess profits tax return, disclosing a tax liability aggregating $248,854.70, which was paid in installments during the year 1946. In the appropriate returns for the year 1945, petitioner included in gross income the proceeds from the contracts with the War Department above referred to. (R. 13.)

Subsequent to the filing of petitioner's returns for 1945, the Commissioner of Internal Revenue made certain adjustments in petitioner's net income for that year, as a result of which the net taxes paid by the petitioner for the year 1945 aggregated $120,614.82. (R. 13.)

Included in those adjustments was a credit in the amount of $153,811.72 against the taxes theretofore paid by the petitioner, which was required by the provisions of Section 3806 of the Internal Revenue Code by reason of the renegotiation of the prices specified in the contracts between the petitioner and the War Department. (R. 14.)

During the year 1946, pursuant t to the terms of the War Department contracts, t the prices speci-fied in those contracts which had been completed in the year 1945 were subjected t to renegotiation, and as a result of those proceedin gs it was deter-mined and concluded as of Decemb ber 23, 1946, that petitioner had received excessive p profits in 1945 in the amount of $200,000 which mu st be restored to the United States. That indebte dness was satis-fied by the tax credit of $153,811.7 2 above referred to and payment by the petitioner t to the Treasurer of the United States of the amou nt of $46,188.28. (R. 14.)

On March 14, 1949, petitioner f filed a claim for refund for the year 1945 in the amount of $248,854.70, the total amount of ta xes paid for that year. That claim was rejected by the Commis-sioner of Internal Revenue on Fe bruary 23, 1950. (R. 14.) A petition for refund was filed in the Court of Claims, which dismissed it. (R. 14-19.)

ARGUMENT

1. The facts of record disclose t hat the contracts of the petitioner with the War D epartment were completed in the year 1945, and while the face amounts of such contracts were accrued on peti-tioner's books in that year in acc ordance with its method of bookkeeping, that fac t is of no conse-quence because the petitioner w as actually paid the contract proceeds in that year. When the con-

tracts were renegotiated in the year 1946 and excessive profits of $200,000 determined, this produced an overpayment of taxes by the petitioner for the year 1945 in the amount of $153,811.72. The amount of the overpayment was credited against the $200,000 of excessive profits and the petitioner paid to the Treasurer of the United States only the difference amounting to $46,188.28.

The petitioner contends that none of the proceeds of the contracts which were completed in the year 1945 was taxable in that year because the renegotiation proceedings were not completed until the year 1946 and, therefore, the petitioner did not know how much of the contract proceeds it would be permitted to retain. This contention ignores, however, the specific statutory provisions prescribing the procedure for tax purposes in cases where contract prices had been renegotiated. When the Revenue Act of 1942 was under consideration, Congress reviewed the very problem which the petitioner now presents and adopted precise legislation to deal with it, namely, Section 3806 of the Internal Revenue Code, which was added to the Code by Section 508 of the Revenue Act of 1942 (Appendix, *infra*, pp. 13-16).*

Subsection (a)(1) of Section 3806 provides in substance that where income is received or accrued

* Section 3806 of the Code is substantially a codification of the prior ruling of the Commissioner (I.T. 3577, 1942-2 Cum. Bull. 163). This ruling was restated after the enactment of Section 3806 (I.T. 3611, 1943 Cum. Bull. 978).

in a given year under contracts with agencies of the United States and in a subsequent year the contract prices are renegotiated and excessive profits determined, the income for the year in which the profits were received or accrued shall be adjusted for tax purposes. This is precisely what the Commissioner of Internal Revenue did in the present case. In order to insure the effectiveness of this section and to prevent any possibility of a double benefit to a taxpayer, Congress provided in subsection (a)(3) of Section 3806 that:

> The amount of the payment, repayment, or offset described in paragraph (1) * * * shall not constitute a deduction for the year in which paid or incurred.

Congress further provided in subsection (b)(1) of Section 3806 that taxes collected for the prior year upon the amounts determined as excessive profits should be credited against the amount of such excessive profits, leaving only the balance thereof, if any, to be paid by the taxpayer. The record discloses that the Commissioner of Internal Revenue complied in every respect with the specific mandates of the statute, and that the petitioner has paid its precise tax liability for the year 1945. Code Section 3806(a)(1) requires the exclusion from gross income for the year in which the contract prices are paid or accrued of amounts

ascertained in renegotiation proceedings to constitute excessive profits. The Commissioner made the required exclusion in the petitioner's income for the year 1945, but not content with this adjustment, the petitioner is here attempting to exclude from its income the entire amount of the proceeds from the contracts which it completed in that year. Clearly, there is no statutory authority for such exclusion.

The petitioner endeavors to avoid the effect of Code Section 3806 by urging that if the provisions of that section are applicable to its 1945 income, then its methods of accounting would not clearly reflect income and, therefore, its case would come within the exception in subsection (a)(4) of Section 3806, that the provisions of subsection (a) shall not apply in respect of any contract if a taxpayer demonstrates to the satisfaction of the Commissioner that a different method of accounting clearly reflects income, in which case the renegotiation adjustment shall be accounted for with respect to the appropriate year under the different method of accounting. However, petitioner kept its accounts under the accrual method of accounting, and as observed by the court below (R. 18), "there is no evidence in the record that the accrual method of accounting used by plaintiff did not clearly reflect its income for 1945." The court then held that petitioner's method of accounting did clearly reflect its income for the years involved.

If the petitioner's contentions were sustained, the result would be to permit income actually earned prior to January 1, 1946, to escape excess profits taxes since those taxes were repealed as of the close of the year 1945.

2. The facts, as found by the court below on the stipulation of the parties, disclose that the War Department paid to the petitioner in the year 1945 the amounts specified in the contracts which were completed in that year. Petitioner received these amounts under a claim of right and without any restriction upon the disposition and use of the money. Even apart from Section 3806, therefore, the entire amount received would have been taxable in the year 1945, with the right of deduction in the year 1946 of the amount of the excessive profits determined by the Renegotiation Board, under the "claim of right" doctrine. *North American Oil* v. *Burnet,* 286 U.S. 417; *United States* v. *Lewis,* 340 U.S. 590; *Rutkin* v. *United States,* 343 U.S. 130.

The fact that the contracts contained renegotiation provisions does not affect the application of the "claim of right" doctrine. As of December 31, 1945, the petitioner had received the full contract prices and did not know whether renegotiation proceedings would be instituted or whether in the event of such proceedings the Renegotiation Board would determine that excessive profits had flowed from the contracts. Thus, as of the close

of the taxable year it had received income to which it was then entitled and which constituted taxable income for that year despite the fact that it might be required to restore a portion of such income to the payor in a subsequent year.

3. Petitioner also argues that the face amount of the contracts should not have been accrued on its books during the year 1945 because of the contingency of renegotiation. On the facts of record, however, no question of accrual accounting is presented. These facts disclose that the petitioner was paid the specified contract prices during the year 1945, and, as observed in *Chestnut Securities Co.* v. *United States,* 104 C. Cls. 489, 495, accrual does not survive payment. However, even if a question of proper accrual were involved, Section 3806 contemplates the prescribed adjustments not only in those instances where payment is received but also where the income had been accrued on the taxpayer's books.

In so far as the accrual method of accounting is concerned, it is firmly established under that method that income should be accrued in the year in which the right to receive it matures, and that deductions should be taken in the year in which the events occurred which fixed the liability. It is only in those cases where the liability itself is contested that accrual may be deferred until that question has been resolved. *Lucas* v. *American Code Co.,* 280 U.S. 445; *Burnet* v. *Sanford &*

Brooks Co., 282 U.S. 359; *Harrold* v. *Commissioner,* 192 F. 2d 1002 (C.A. 4th); *Continental Tie Co.* v. *United States,* 286 U.S. 290. In *United States* v. *Anderson,* 269 U.S. 422, it was held that where the taxpayer's records were maintained on an accrual basis, all items of income and expenses must be accrued in the proper year, and in *Spring City Co.* v. *Commissioner,* 292 U.S. 182, this Court held that where books are kept on the accrual basis, the right to receive income and not the actual receipt determines whether the amount thereof should be included in gross income. None of the cases cited by the petitioner, including *Lichter* v. *United States,* 334 U.S. 742, which upheld the constitutionality of the Renegotiation Act of 1943, appears to disturb this established principle.

The contentions of the petitioner completely ignore the fundamental principles of our scheme of taxation and the normal concepts of accrual accounting. If there is one principle firmly embedded in our scheme of taxation, it is that taxes are imposed on an annual basis. *Burnet* v. *Sanford & Brooks Co., supra,* pp. 363, 365; *Security Mills Co.* v. *Commissioner,* 321 U.S. 281, 286-287; *Arrowsmith* v. *Commissioner,* decided by this Court, November 10, 1952.

Under this principle, all items of income and deductions attributable to a particular taxable

year must be accounted for in that year regardless of whether a taxpayer maintains its books and records on the cash or accrual basis. The obvious effort of the petitioner is to avoid excess profits taxes on income received during a year when such taxes were in effect, but completely ignores the effect its success would have upon other taxpayers in later years. By Section 101 of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137 (26 U.S.C. 1946 ed., Supp. IV, Sec. 430), Congress enacted Section 430 of the Internal Revenue Code, which restored to our scheme of taxation the excess profits tax impositions, beginning July 1, 1950. If the petitioner's arguments prevail, all taxpayers who completed Government contracts during non-excess-profits tax years and which were renegotiated subsequent to July 1, 1950, would be subject to excess profits taxes on the net amounts received or accrued under those contracts notwithstanding the fact that at the time the contracts were completed and paid for, such amounts were not subject to excess profits taxes. This would result in distortion of established principles of accounting and taxation.

CONCLUSION

The petition for certiorari presents no question warranting review; there is no present conflict of decisions; and the decision of the Court of Claims is correct. The petition should be denied.

Respectfully submitted,

WALTER J. CUMMINGS, JR.,
Solicitor General.

CHARLES S. LYON,
Assistant Attorney General.

ELLIS N. SLACK,
JOSEPH H. SHEPPARD,
Special Assistants to the Attorney General.

DECEMBER, 1952.

APPENDIX

Internal Revenue Code:

SEC. 3806 [as added by Section 508, Revenue Act of 1942, c. 619, 56 Stat. 798]. MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT.

(a) *Reduction for Prior Taxable Year.*—

(1) *Excessive profits eliminated for prior taxable year.*—In the case of a contract with the United States or any agency thereof, or any subcontract thereunder, which is made by the taxpayer, if a renegotiation is made in respect of such contract or subcontract and an amount of excessive profits received or accrued under such contract or subcontract for a taxable year (hereinafter referred to as "prior taxable year") is eliminated and, in a taxable year ending after December 31, 1941, the taxpayer is required to pay or repay to the United States or any agency thereof the amount of excessive profits eliminated or the amount of excessive profits eliminated is applied as an offset against other amounts due the taxpayer, the part of the contract or subcontract price which was received or was accrued for the prior taxable year shall be reduced by the amount of excessive profits eliminated. * * *

* * * * *

(3) *Deduction disallowed.*—The amount of the payment, repayment, or offset described in paragraph (1) or paragraph (2) shall not constitute a deduction for the year in which paid or incurred.

(4) *Exception.*—The foregoing provisions of this subsection shall not apply in respect of any contract if the taxpayer shows to the satisfaction of the Commissioner that a different method of accounting for the amount of the payment, repayment, or disallowance clearly reflects income, and in such case the payment, repayment, or disallowance shall be accounted for with respect to the taxable year provided for under such method, which for the purposes of subsections (b) and (c) shall be considered a prior taxable year.

(b) [As amended by Section 701(c), Revenue Act of 1943, c. 63, 58 Stat. 21, and Section 14(b), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *Credit against Repayment on Account of Renegotiation or Allowance.*—

(1) *General rule.*—There shall be credited against the amount of excessive profits eliminated the amount by which the tax for the prior taxable year under Chapter 1, Chapter 2A, Chapter 2B, Chapter 2D, and Chapter 2E, is decreased by reason of the

application of paragraph (1) of subsection (a) * * *

* * * * *

(3) *Credit for barred year.*—If at the time of the payment, repayment, or offset described in paragraph (1) or paragraph (2) of subsection (a), refund or credit of tax under Chapter 1, Chapter 2A, Chapter 2B, Chapter 2D, or Chapter 2E, for the prior taxable year, is prevented (except for the provisions of section 3801) by any provision of the internal-revenue laws other than section 3761, or by rule of law, the amount by which the tax for such year under such chapters is decreased by the application of paragraph (1) or paragraph (2) of subsection (a) shall be computed under this paragraph. There shall first be ascertained the tax previously determined for the prior taxable year. The amount of the tax previously determined shall be the excess of—

(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return (determined as provided in section 271 (b) (1) and (3)), if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

(2) the amount of rebates, as defined in section 271(b)(2), made.

There shall then be ascertained the decrease in tax previously determined which results solely from the application of paragraph (1) or paragraph (2) of subsection (a) to the prior taxable year. The amount so ascertained, together with any amounts collected as additions to the tax or interest, as a result of paragraph (1) or paragraph (2) of subsection (a) not having been applied to the prior taxable year shall be the amount by which such tax is decreased.

* * * * *

(c) *Credit in Lieu of Other Credit or Refund.*—If a credit is allowed under subsection (b) with respect to a prior taxable year no other credit or refund under the internal-revenue laws founded on the application of subsection (a) shall be made on account of the amount allowed with respect to such taxable year. * * *

(26 U.S.C. 1946 ed., Sec. 3806.)

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